Navigating Loan Repayment for Med School Graduates

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Medical school is expensive, and during the low-paid residency period that follows, young doctors have to service a massive load of debt. How should residents and young physicians tackle this debt load while saving for their short and long term goals?

For many medical students, taking out student loans is well worth the investment. Becoming a physician can have the reward of higher earning potential, and the ability to do something that they would enjoy more than any other occupation.

Most medical students rely heavily on student loans to make it through med school. In fact, according to the American Association of Medical Colleges, in 2016, 76% of graduating medical students had student debt. The average educational debt of these graduates was a staggering $189,165. When residency begins, many of them are faced with tough financial decisions due to their high debt load, low income and long-term financial goals.

Separate Good and Bad Debt

After you graduate, you will want to separate your debt into two categories: good debt and bad debt. Debt with high interest rates or non-tax-deductible are bad debt. This includes credit card debt, some auto loans and some unsubsidized student loans. Good loans carry low interest rates, can be deductible against income, and have the potential for loan forgiveness. Some examples of good debt are mortgages, and some student loans.

Your debt repayment plan should focus on eliminating the highest interest-bearing (bad) loans first, and working your way to the lowest interest bearing (good) loans last. This is why you shouldn't consolidate your loans, because it limits your ability to selectively pay off the bad ones while making minimum payments on the good loans.

You should also see if you can replace bad debt with good debt. Among the ways to do this: refinancing your mortgage, taking out a home equity line of credit to pay off credit card debt or student loans. This is an effective way to transform bad debt into good debt. Using these strategies can save you thousands of dollars in interest, loan forgiveness, or lower taxes over the course of the loans.

It is important to also understand what loans can be forgiven, and if so plan appropriately for the loan forgiveness.

Set up a debt repayment plan that you can manage

After graduation, residents earn somewhere between $40,000 and $60,000 during their first year. Because of the high loan to income ratio, many residents find it difficult to pay down their loan balance during residency (and rightfully so). Here are some options for student debt repayment plans.

10 year Repayment Plan

The standard repayment plan for student loans is the **10-year repayment plan**. Assuming a student loan of $189,165 (average educational debt of med grads), at a 6.31% interest rate for federal loans, the payment is $2,130 per month or $25,556 per year. Since that's roughly half of a resident's pre-tax salary, many simply cannot afford to make the minimum payments on a 10-year plan. This is fine for residents with a low amount of debt or income from another source, but for residents that have a high amount of debt and modest income, there are more reasonable options available from a current cash flow perspective.

25 Year Repayment Plan

A **25-year extended repayment plan** reduces the monthly payments considerably. The monthly payment for this plan is $1,254, or about $15,058 per year. Of course, the longer the repayment period, the more interest you pay over the course of the loan (about $120k more than the 10 year plan!). For some residents, even this lower monthly payment may still be too burdensome to maintain their lifestyle.

Income Driven Repayment Plans

Many residents, who cannot afford a fixed repayment plan, choose some form of a **Pay as You Earn Plan (PAYE) or Income-Based Repayment Plan (IBR)**, which are payment plans determined by your income. Availability of these plans are dependent of what types of loans you have and when the loans were taken out. These plans use a formula that caps your minimum payment to 10% or 15% of your discretionary income, which is typically lower than the fixed term repayment plans.

If your circumstances change or if you just decide that you want to pay off your loan faster, you can. Enrolling in an income-based repayment plan also allows for debt forgiveness for direct loans. If you faithfully make income-based repayments on time every month, you might qualify for loan forgiveness after 20 or 25 years. If your loans are forgiven under these programs, it is important to plan for the tax implications, as loans forgiven after 20 or 25 year are generally treated as taxable income.

If you work for a non-profit or for a federal, state or local government, debt is forgiven after 10 years of steady repayments under Public Service Loan Forgiveness (PSLF). To have debt forgiven, you need to work full time for a qualified employer, and make all of your payments on time. The best part about this loan forgiveness program is that the loans forgiven are tax free!

For many medical residents, income-based repayment provides the most flexibility, but comes with some disadvantages. Because the minimum payment is based on your income, you need to submit paperwork every year to determine your minimum payment. Also, making the minimum payment means you pay more interest in the long run.

Because income for many doctors significantly increases after residency, so will the minimum payments. You probably won't carry a loan balance after 20 or 25 years, meaning many doctors under this repayment plan are unable to take advantage of the debt forgiveness program unless they are a public service worker.

It is important to plan for any loan forgiveness, as this will be an important factor in determining which loans to aggressively pay down once you have the cash flow to do so. If your loans are projected to be forgiven, you will likely want to make minimum payments throughout the term of the loan. If not, it likely make sense to aggressively pay these loans off, as they likely carry a higher interest rate than other debt. This tool may help you determine whether or not you will be eligible for loan forgiveness.

Because every situation is unique, and there are several additional factors to consider when creating a debt repayment plan (how to file taxes, whether or not to refinance, etc.), you should seek the help of a financial advisor. Many advisors have experience helping young doctors, and they can give individual advice for making a debt repayment plan.